

# INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) ADOPTION AND KEY FINANCIAL RATIOS: INSIGHT FROM LISTED BANKS IN NIGERIA

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## Abstract

Financial ratio is one of the performance measure used by investors to determine the viability of a firm. In view of this assertion, this paper investigates the effects of IFRS on key financial ratios of 11 listed banks in Nigeria. The study addresses the research hypotheses by comparing the key financial ratios computed under the NGAAP for three year period from 2009-2011 and three year period from 2013-2015 under IFRS regime. Profitability ratio, short term solvency ratio, long term solvency ratio and investment ratio were used as a proxy for key financial ratios. The study used Kolmogorov-Smirnov test and Mann Whitney U-test as a statistical method to analyze the data. The findings show that NGAAP has a higher mean score in terms of long term solvency ratios ( $4.94 > 2.25$ ) and investment ratios ( $4.03 > 4.02$ ) while IFRS reveals a higher mean score for profitability ratios ( $4.54 > 2.97$ ) and short term solvency ratios ( $4.52 > 3.02$ ). The finding implies that neither IFRS nor the NGAAP provided a higher performance of ratios. Therefore, mixed results obtained from the study. The research recommends that investors and financial analyst should pay particular attention to all financial ratios under this IFRS regime.

**Keywords:** Key financial ratios, IFRS, Nigerian GAAP, Profitability ratio

## Introduction

The quest for high quality and uniformity in the preparation of financial statement led to the introduction of International Financial Reporting Standards (IFRS) which was formerly called International Accounting Standards (IAS) (Donwa, Mgbame & Idemudia, 2015). In 2012, Nigeria joined other countries to adopt IFRS in order to improve its preparation of the financial report. A number accounting literature showed that high quality accounting standards and its appropriate application are perceived as providing relevant, reliable and comparable financial information from one accounting year to another (Khanagha, 2011; Erin, Olojede & Ogundele, 2017). Understanding the impact of IFRS on a firm's financial ratio is critical to investors, regulators, auditors, financial analysts, academia and others in order to take an informed decision.

Financial Accounting Standard Board (2008) posits that IFRS main objective is to produce a high set of accounting standards that are able to present quality financial reporting information. Financial ratios are set of accounting parameters and standards used by relevant stakeholders of financial statement to determine the viability or otherwise of firm's

performance. Ball (2006) opined that IFRS adoption has led to a more accurate, precise and comprehensive financial statement. IFRS has improved the value relevance of accounting information to shareholders for them to make a sustainable or substantial investment regarding firm financial performance. Investors basically rely on management to make available relevant information in the financial statement on whether to invest or reinvest after assessing the key financial ratios and value of a firm (Umoren & Enang, 2015). The key performance indicator mostly used by firms or listed entities are the profitability, liquidity and gearing measures. Its aim is to determine the strength and weaknesses of an organization.

The increase in the globalisation of accounting language for financial reporting has resulted in the International Financial Reporting Standards (IFRS). Although different accounting standards were used in different countries and this brought about major changes in financial statement and accounts. However, the aim of IFRS is for countries to have a common and comparable financial statement across cross borders that are able to facilitate national economic growth (Ibiamke & Ateboh-briggs, 2014). Land and Lang (2002) posit that harmonization of accounting standards globally improves accounting quality which invariably presents a more relevant information to investors and shareholders. Consistent with this report, Barth, Landsman, & Lang (2008) believe that the introduction of IFRS has resulted in fewer earnings management issues in most organizations due to high and reporting nature of IFRS.

Previous literature (Barth et al., 2008; Lee, Waler & Christensen, 2008; Emeni, Uwuigbe, Uwuigbe & Erin, 2016) showed that accounting quality has improved immensely due to the voluntary IFRS adoption in various countries. In support of this view, Hung & Subramanyam (2007) revealed that the implementation of IFRS has reduced information asymmetry between managers and shareholders. The need for harmonization of accounting standards increased in order to help standardizes companies' financial statement especially international investors whose interest is across the globe. It is important to note that different accounting standards in different countries harmonize to form a single set of an accounting standard. Lee et al. (2008) argued that if IFRS is important then firms in countries that have lower disclosure quality and equity financing prior to mandatory IFRS should experience a great impact after mandatory adoption.

The spate of corporate scandals (Toshiba accounting scandal, 2015; Lehman, 2008) in the last ten years of big companies globally and in Nigeria has cast doubt on the quality of financial disclosure especially key financial ratios reported by most firms. This development has led to the loss of confidence on the information disclosure by firms. The corporate scandals point to weak corporate governance, inadequate accounting standards, and creative accounting. The weak financial disclosure has necessitated the emergence of high quality accounting standards in order to improve the quality of financial information disclosed. In Nigeria, there are several cases of corporate failures (Cadbury Plc., Lever Brothers (presently known as Unilever Nigeria Plc., banks failures). All these are linked to weak corporate governance, ineffective accounting standards and poor financial disclosure system (Adeyemi & Fagbemi, 2010; Umoren, 2010; Wallace, Naser, & Mora, 1994).

Therefore, against this backdrop, this study seeks to examine whether the introduction of IFRS has led to improvement in key financial ratios than under the Nigerian GAAP in the Nigerian listed banks. Previous studies (Ibiamke & Ateboh-briggs, 2014; Zayyad, Ahmed, and Mubaraq, 2014, Uwuigbe, Erin, Uwuigbe, Peter & Jinadu, 2017) have resulted in the inconsistency and mixed findings, therefore, we are motivated to carry out this study to fill in the existing gaps in this study. Specifically, the objective of this study is to compare IFRS adoption of key financial ratios with key financial ratios under the NGAAP period of listed banks in Nigeria.

The rest of the paper is organized as follows. Section 2 discusses the literature review. Section 3 discusses the research method adopted as well as specification of the model. It proceeded to Section 4 which presents information regarding the data analysis and empirical results and Section 5 concludes the paper.

### Conceptual Framework

The aim of IFRS is to provide a single set of high quality global accounting standards and accurate financial reports to improve comparability and provide value relevant information to investors and other stakeholders (Blanchet, Raciocot & Girar, 2011). IFRS was developed through the International Accounting Standard Board (IASB) in order to ensure uniformity and standardization of accounting standards globally. Blanchett et al. (2011) examined that the features of

IFRS which included the principle based approach, concept of comprehensive income and fair value orientation. The adoption of IFRS was adopted in Nigeria by all stakeholders in January 2012 according to IFRS roadmap committee report in 2010. The milestones for this development was stated into three stages; these stages comprise of the public interest entities which were expected to adopt IFRS in January 2012, other public interest entities to adopt IFRS in Jan 2013 and the small medium sized enterprise (SMEs) which was adopted in Jan 2014.

The conceptual framework is to investigate the effect of IFRS adoption and key financial ratio evidence from listed banks in Nigeria. This study tends to bridge the gap by providing a basis for good judgement of the effect of IFRS adoption and key financial ratios. Financial ratios are used for various purposes. It includes the ability to pay debts, evaluate business and managerial success and statutory regulation of a firm's performance. The need for a firm's target is determined by its financial ratios but firms do not adjust their financial ratios to such target though the effect of IFRS as it relates to companies affects the financial condition of the companies (Agas & Aktas, 2007).

Financial ratios are used by various financial users such as stakeholders, investors, brokers and financial analysts in other to analyse the financial performance or financial condition of a company (Blanchette et al., 2011). There are four commonly used financial ratios in accessing a firm and they are profitability ratios, short term solvency ratios, long term solvency ratios and investment ratios. The differences in recognition between IFRS and GAAP can be greatly affected by the numerator of ratio calculation or the denominator. The financial ratios will be calculated based on the GAAP compared with the calculated ratio of IFRS.

### Review of Prior Literature

Several works on the effect on IFRS and key financial ratios have been conducted. Blanchett et al. (2011) examined the effect on IFRS on financial ratios in view of liquidity, leverage profitability and coverage in Canada and his findings was that there is practically no difference between ratios under IFRS and Canadian GAAP and that analyst who uses ratios for analytical purpose has to be very careful because there may be no basis for comparison. Punda (2011) investigated the impact of IFRS adoption on key financial ratios of entities listed in the UK and from his findings, the conversion from UK GAAP to IFRS brought about a major difference in key financial ratios and secondly it was observed that there were an increase in net profit and current liabilities while a decrease in equity.

Latridis (2010) examined the transition effect of IFRS on financial reporting in the UK and with the help of the study, it was found that IFRS adoption had a significant effect on the financial performance of companies in the UK and that fair value principle brought about an increase in income. Similarly, Umoren and Enang (2015) examined IFRS adoption and value relevance on financial statement of Nigerian listed banks by using the least square regression and descriptive statistics and the study found that value relevance of earnings per share increased during the post IFRS period while book value of equity per share was reduced, the study concluded that more measures should be put in place in other to increase and enhance financial reporting on value relevance.

Onipe, Onyabe, and Usman (2015) examined the effect of IFRS on value relevance and key financial indicators, the study found that IFRS has a positive and significance impact on the value relevance of accounting information. Ibiameke and Ateboh-briggs (2014) examined the financial ratios as it affects IFRS adoption in Nigeria. The paired sample t test and correlation analysis were used as their statistical method; the findings show that IFRS adoption has caused a negative impact on financial ratios of listed companies in Nigeria.

Zayyad, Ahmed, and Mubaraq (2014) examined financial ratios as performance measures and the study was compared using IFRS and Nigerian GAAP, Kolmogorov minor test was used to test the normality of data and Mann Whitney test was also conducted to show the significant differences/existence on the pair of ratios. It was concluded that IFRS disclosure on financial statement could not increase performance evaluation of listed firms in Nigeria through the ratios. Rainsbury, Diego, and Walker (2010) examined the financial statement impact of adopting IFRS in New Zealand and their findings shw that 87% of firms are affected by IFRS adoption in New Zealand and the median and interquartile range indicates that in most firms the impact on IFRS in New Zealand is small.

Hung and Subramanyams (2007) examined the effect of adopting IFRS on the financial statement and value relevance and it was discovered from their observation that the new regime on German accounting standards had a greater emphasis on the balance sheet and fair valuation, but less focus on income smoothing. On the other hand, McConnell (2012) adopted fifty Canadian firms and examined IFRS impact from 2010-2011 and his focus was on a descriptive statistic that exhibited a non-normal distribution of mean and median. The study found that IFRS has a positive impact on financial ratios.

Terzi, Oktem, and Sen (2013) conducted a study on IFRS and financial ratios of manufacturing firms in Turkey, the study adopted a logistic regression model for empirical analysis and found that IFRS has a significant impact on inventories such as shareholder equity, long term liabilities, fixed assets. The study further found that assets turnover ratios, current ratios, and financial leverage ratios are significant and positively affected by the new regime. Daske and Gerhardt (2006) investigated the effect of IFRS adoption of three European countries on accounting quality and the study discovered that accounting quality significantly increased in the sampled companies listed who have voluntarily adopted IFRS. In the same vein, Gerbhardt and Novotny-Farkas (2011) examined the implication on IFRS for 12 European countries on a mandatory adoption and found out that the recognition losses under IAS 39 reduced and led to less timely loan. Aubert and Grudnitski (2011) analysed the importance and impact of mandatory IFRS adoption of different European firms, in order to access the impact of a mandatory IFRS adoption. He analysed returns on the asset and compared the two standards between IFRS and the local standard and found that under IFRS there were significantly higher accruals compared to the local standard.

Agas and Aktas (2007) analysed a similar view with Terzi et al. (2013) and they conducted a study on Turkish firms from 2004-2005 with the T-test and the study found that only current ratios and net asset turnover ratios are affected by IFRS. Agostino, Drago, and Silipo (2011) examined the consequences of a compulsory adoption of IFRS from a stewardship perspective and it was claimed that earnings are more informative after the introduction of IFRS. It was expected that their role is more important in a firm's internal performance evaluation. Lantto and Sahlstrom (2009) conducted a research on the impact of IFRS adoption on key financial ratios of Finnish listed firms and the study found that the adoption of IFRS drastically changed the magnitude on key accounting ratios of the Finnish company. Punda (2011) examined the effect of the adoption on the key financial ratios in UK listed firms. He discovered a substantial change in the key performance indicator on post IFRS adoption.

### **Theoretical Framework**

This study explains the effect of IFRS adoption on key financial ratios of some listed banks. Therefore, for the essence of this study, agency theory is being applied. Agency theory addresses the relationship between shareholders (principal) and an agent which is the company's executive. However, agency theory provides a rationale for these two variables. The principals are the shareholders, while the agents are the firm's executives (managers); one party (principals) employs the other party (agents) to manage the company on their behalf. The agents may pursue other goals and interest that may be different from that of the agents (agency problem). According to Duru and Tsitinidis (2013), managers in banks are always under pressure to provide high returns; and as such, the principals are willing to provide some form of incentives to managers. With such incentives, bank managers using accounting preferences will attempt to disclose high income even in a period of losses.

**Table 1: Summary of Findings**

Author(s)	Title	Main Findings
Umoren and Ekwere (2015)	The study examines IFRS adoption and value relevance of financial statement of Nigeria listed banks	Earnings per share increased value relevance during the post IFRS period and reduced the book value of equity per share
Yhlas (2015)	The study showed the effect of IFRS on value relevance and key financial indicators.	IFRS had a positive and significant impact on value relevance.
Ibiamke and Ateboh-briggs (2014)	The study examined the financial ratios as it affects IFRS adoption in Nigeria.	IFRS adoption has caused a negative impact on financial ratios of listed companies in Nigeria.
Zayya, Ahmed, and Mubaraq (2014)	Financial ratios as performance measures between IFRS and Nigerian GAAP.	IFRS disclosure on financial statement was not attainable in an increased performance evaluation through the ratios.
Blanchelle (2011)	Effect on IFRS on financial ratios in view of liquidity, leverage profitability and coverage	Principle based approach actually improved transparency, the concept of comprehensive income and fair value orientation.
Punda (2014)	The study investigated the impact of IFRS adoption on key financial ratios entities listed in UK	The study found out that they were an increase in net profit and current liabilities and a decrease in entities.
Latridia(2010)	Effect on IFRS on financial reporting in UK	The study showed a significant effect on the financial performance of companies in the UK and fair value due to the adoption that brought about the vitality in income.
Lantto and Sahlstrom(2009)	Impact of IFRS adoption on key financial ratios of listed entities.	He found out that there was a dramatic change on the key accounting ratios of the listed firms

### **Methodology and Model Specification**

The purpose of this research is to investigate empirically the significance difference between the Nigeria GAAP (NGAAP) and IFRS of key financial ratios of listed banks in Nigeria. This was done by comparing the financial ratios computed under NGAAP with those computed under IFRS for three years period under each regime, from 2009 to 2011 under NGAAP regime and 2013 to 2015 under IFRS regime. The population under study are 15 listed banks on the Nigerian Stock Exchange as at 31st December 2015 (Nigerian Stock Exchange Factsheet, 2015). The sample size consists of 11 banks which were derived through Taro Yamane formula.

The study relies on secondary data. Data were obtained from the banks' annual report for the periods 2009 to 2011 under the NGAAP regime while 2013 to 2015 for IFRS regime. The mean differences between the two regimes were considered. The empirical analysis was performed to check if there is a significant difference between the ratios prepared under IFRS regime and NGAAP regime. Data analysis method used was Mann-Whitney Test statistics; this is to enable the study test for significant difference among the selected financial ratios for the IFRS and NGAAP period. The following null hypotheses were tested:

H<sub>01</sub>: Profitability ratio does not show a significant difference for financial statement prepared under NGAAP and IFRS of listed banks in Nigeria.

H<sub>02</sub>: There is no significant difference between short-term solvency ratio prepared under NGAAP and IFRS of listed banks in Nigeria.

H<sub>03</sub>: There is no significant difference between long-term solvency ratio prepared under NGAAP and IFRS of listed banks in Nigeria.

H<sub>04</sub>: There is no significant difference between investment ratio prepared under NGAAP and IFRS of listed banks in Nigeria.

**Model Specification**

To examine the difference between NGAAP and IFRS based on financial ratios for the sampled period. We developed the following regression:

$$NGAAP_{it} = \beta_0 + \beta_1 \Sigma PROFITABILITY_{it} + \beta_2 \Sigma SHTERMSOL_{it} + \beta_3 \Sigma LGTERMSOL_{it} + \beta_4 \Sigma INV_{it} + \epsilon_{it} \dots \dots \dots (I)$$

$$IFRS_{it} = \beta_0 + \beta_1 \Sigma PROFITABILITY_{it} + \beta_2 \Sigma SHTERMSOL_{it} + \beta_3 \Sigma LGTERMSOL_{it} + \beta_4 \Sigma INV_{it} + \epsilon_{it} \dots \dots \dots (II)$$

Where  $\Sigma PROFITABILITY_{it}$  includes ratios under profitability ratios which are:

- GPM- Gross Profit Margin
- NPM- Net Profit Margin
- ROCE- Return on Capital Employed
- $\Sigma SHTERMSOL_{it}$  includes ratios under short term solvency which are:

- CR- Current ratio
- ATM- Acid Test Ratio

$\Sigma LGTERMSOL_{it}$  includes ratios under long term solvency which are:

- DR- Debit Ratio
- GR- Gearing Ratio
- CFR- Cash Flow Ratio

$\Sigma INV_{it}$  includes ratio under investment ratio which are:

- EPS- Earnings per share
- DPS- Dividend per share
- DP- Dividend Pay-out

**Results and Discussion**

In this section, we present the descriptive and inferential results obtained from the study; findings from the results are also discussed on the basis of the literature.

This section presents One-Sample Kolmogorov-Smirnov Test. There are eleven (11) financial ratios computed for IFRS and NGAAP respectively, making a total of 66 firm observation for the six year period.

**Table 1: One Sample Kolmogorov-Smirnov Test**

N	Mean	Std. Dev.	K-S Value	Sig.
66	2.4214	8.5124	1.897	0.002

Source: Authors’ Computation (2017) using SPSS Version 20

The above result reveals the level of significance (0.002) which is lesser than 5% (0.05); this implies that the overall data do not follow a normal distribution pattern. This result negates the assumption of normality. Normality level is assumed when a level of significance is higher than 0.05. Therefore, the best possible option is to consider non-parametric statistical mean (AbdulRahim, 2009). In table 3 below, we performed Mann-Whitney test at 5% significance level as a non-parametric test to determine the mean difference of IFRS and NGAAP for the sampled period

**Table 2: Descriptive Statistics**

Variables	NGAAP					(2013-2015) IFRS				
	N	Max	Mean	(2009-2011) Min	Std. Dev.	N	Max	Mean	Min	Std. Dev.
<b>PROFITABILITY</b>										
GPM	3 3	0.13	0.165	0.07	0.0162	33	0.15	0.19	0.08	0.0251
NPM	3 3	0.035	0.041	0.012	0.0132	33	0.047	0.06	0.017	0.0184
ROCE	3 3	0.06	0.072	0.024	0.0145	33	0.072	0.09	0.031	0.0127
<b>Overall Mean</b>			<b>0.093</b>					<b>0.11</b>		
<b>SHTERMSOL</b>										
CR	3 3	1.02	1.315	0.57	0.1242	33	1.061	1.32	0.52	0.1405
ATR	3 3	0.75	0.99	0.48	0.0757	33	0.86	1.09	0.45	0.0841
<b>Overall Mean</b>			<b>1.152</b>					<b>1.20</b>		
<b>LGTERMSOL</b>										
DR	3 3	0.712	1.0245	0.625	0.0781	33	0.69	1	0.61	0.0691
GR	3 3	0.512	0.7266	0.429	0.0847	33	0.492	0.65	0.312	0.0724
CFR	3 3	0.25	0.2505	0.001	0.0693	33	0.25	0.2	-0.11	0.1214
<b>Overall Mean</b>			<b>0.667</b>					<b>0.48</b>		
<b>INV</b>										
EPS	3 3	19.51	22.57	6.12	5.792	33	17.69	20.3	5.19	4.6213
DPS	3 3	5.42	6.635	2.43	1.7201	33	9.24	11.4	4.25	2.7144
DP	3 3	0.651	0.721	0.14	0.3145	33	0.79	0.9	0.21	0.322
<b>Overall Mean</b>			<b>9.9753</b>					<b>9.24</b>		

Source: Authors' Computation (2017) using SPSS Version 20

Table 2 summarizes the three years under NGAAP and three years under IFRS period for each category of ratio. The overall and individual category of ratios under the profitability indicates that IFRS regime shows a higher profitability ratio than under NGAAP. Similarly, the short term solvency also shows a slight increase under the IFRS while the current ratio (CR) presents almost the same figure under the two regimes. However, the long term solvency presents a contrary result where the NGAAP indicates a higher result for each category of ratios. The investment ratios provide a mixed result where the dividend per share (DPS) and dividend pay-out (DP) are higher under the IFRS while the earnings per share (EPS) is higher under the NGAAP.

The comparison of the above financial ratios shows that neither the IFRS nor the NGAAP provides a better and higher performance evaluation of financial ratios due to the mixed results obtained. Thus, this leads us to provide answer to the study's research question that financial ratios under the IFRS regime do not in any way present a better performance

evaluation to financial ratios than the NGAAP except for the short term solvency ratio and profitability ratio where the IFRS has two of the ratios higher than NGAAP

In order to further investigate whether there are significant differences in the above result, we present in the table below using Mann-Whitney Test for each category of ratio.

**Table 3: Mann-Whitney U-Test Prepared from NGAAP and IFRS Financial Statement for Each Category of Financial Ratios**

Ratios	Standards	N	Mean Rank	Sum of Ranks	Z- Statistics	Sig
<b>PROFITABILITY</b>	NGAAP	33	2.97	13.00		
	IFRS	33	4.54	6.00	-1.349	0.04
<b>SHTERMSOL</b>	NGAAP	33	3.02	10.00		
	IFRS	33	4.52	14.00	-0.572	0.025
<b>LGTERMSOL</b>	NGAAP	33	4.94	12.00		
	IFRS	33	2.25	8.00	-0.925	0.04
<b>INV</b>	NGAAP	33	4.03	11.00		
	IFRS	33	4.02	11.00	-0.729	0.015

Source: Authors' Computation (2017) using SPSS Version 20

Table 3 presents the results of Mann-Whitney U-Test for both NGAAP and IFRS. The background analysis of the data shows that NGAAP has a higher mean score in terms of long term solvency ratios (4.94 > 2.25) and investment ratios (4.03 > 4.02) while IFRS reveals a higher mean score for profitability ratios (4.54 > 2.97) and short term solvency ratios (4.52 > 3.02). Although the treatment of investment ratio is quite different under the two periods; in the NGAAP, the proposed dividend is treated as a liability while under IFRS, the proposed dividend is treated as an asset. This result is consistent with the findings of Ibiameke & Ateboh-briggs, 2014; Zayya, Ahmed & Mubaraq, 2014 which shows that the adoption of IFRS does not in any way superior to NGAAP as revealed in the empirical result.

**Decision**

- H<sub>0</sub>1: Accept (IFRS higher under profitability ratios)
- H<sub>0</sub>2: Accept (IFRS higher under short-term solvency ratios)
- H<sub>0</sub>3: Reject (IFRS lower under long-term solvency ratios)
- H<sub>0</sub>4: Reject (IFRS lower under investment ratios)

**Conclusion**

The study investigates the effect of IFRS on key financial ratios of listed banks in Nigeria. Based on the overall findings, the comparison of the above key financial ratios shows that neither the IFRS nor the NGAAP provides a better and higher performance evaluation of financial ratios; this is due to the mixed results obtained in the study. Using the Mann-Whitney U-Test, the study found that IFRS adoption has led to a decrease in investment ratios and long term solvency ratios; however, the decrease is not statistically significance at 5% level. The study also revealed that profitability ratios and short term solvency increased from NGAAP to IFRS period. In conclusion, the adoption of IFRS does not have significant and positive effects on key financial ratios of listed banks in Nigeria.

The study recommends that investors and financial analyst should pay particular attention to all financial ratios under this IFRS regime. This study only examined the listed banks in Nigeria; future research could cover the entire financial sector in order to provide a robust insight into the effect of IFRS the key financial ratio in Nigeria. This study adds to the body of literature in accounting research in relation to the impact of IFRS on key financial ratios in different climes.

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